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Update Bulletin December 30, 1982

COMMODORE INTERNATIONAL LIMITED (CBU-NYSE)

Current Price	52-Week Range	Earnings Per Share* 1982	1983E	1984E	1984E P/E Ratio	Return on Shareholders' Equity 1983E
$68	$23-85	$2.64	$4.60	$7.20	9.4x	50.1%

*Fiscal Year Ends June 30th.
Shares outstanding: 15,360,000 (9/30/82).

Introduction

Commodore International is emerging as one of the largest United States corporations.

Commodore has been widely acknowledged as the leading micro-computer company outside the United States, with its position in the United States believed to be third or fourth (behind Apple, Tandy and, possibly, IBM).

While such a distinction is commendable, what is not widely recognized is the fact that Commodore is really much larger and far more prominent than is perceived, something we believe will receive much more attention in the months ahead.

We estimate Commodore's current annualized sales rate at approximately $600 million, this placing it in the 434th position out of the 500 largest industrial companies in the 1981 Fortune listing (had this sales level been achieved in 1981); the

company's return on average shareholders' equity of 52.9% for its most recent fiscal year would have placed it in the number three slot in the 1981 Fortune 500, while a similar number two or three position is likely to be realized in 1982.

Commodore's current rate of microcomputer production of well over 100,000 units monthly makes it the largest microcomputer company in the world in terms of production.

Based upon current sales trends, it is also quite possible that the company's overall sales levels measured in dollars will, within three-to-six months, or by the end of the March or June quarter, place it in the number one microcomputer company position worldwide, ahead of Apple, Tandy, and IBM!

When some or all of the above are more widely perceived, we believe that the market will place a premium price-to-earnings valuation on Commodore's shares, something that should lead to very wide stock price appreciation over the next 1-3 years.

Summary

On Monday, August 2, 1982, Texas Instruments announced a $100 price rebate on its 99/4A home computer, a development that sent shock waves through all microcomputer stocks over the remaining weeks in August.

The shares of Commodore, which had been trading in the $38-$40 range immediately before the announcement, plunged to $26-$27 within one week.

On August 4, 1982, or two days after the Texas Instruments' announcement, we published an Update Bulletin wherein we recommended purchase of Commodore shares at a (then) price of $31, citing the fact that we believed the price cut would not impact Commodore's earnings and could, in fact, aid sales since lower prices would help stimulate sales as price elasticity came into play.

Since then, Commodore's first quarter (ended September 30, 1982) sales and earnings were reported and exceeded even optimistic expectations. (This is discussed in detail on page 3.)

Based upon our recent in-store surveys of the demand for Commodore's under $200 VIC 20 home computer together with the initial demand for its new $595 Commodore 64 personal computer, coupled with a rapid ramp-up in Commodore's production capacity,

we believe the current quarter's sales and earnings will, once again, exceed, possibly by a wide margin, the most optimistic forecasts.

The longer-term outlook for Commodore also now appears better than ever. Current existing microcomputer demand is excellent. New microcomputer systems introductions scheduled for 1983 coupled together with the rapid emergence of strong public recognition of the Commodore name linked to its major advertising campaign, leads us to conclude that Commodore has clear sales and earnings visibility through at least the next 2-3 years.

Commodore sales and earnings per share have been growing at an uninterrupted rate in excess of 50% annually for the past five years. Fiscal 1983 growth is estimated to be more than 70% with a growth rate of 50%+ projected for fiscal 1984.

Now midway through fiscal 1983, we believe investors focus will shortly turn to fiscal 1984. Commodore International common stock is now selling at 9.4x estimated fiscal 1984 earnings per share of $7.20.

We believe that sometime during the next fiscal year, the price-to-earnings multiple afforded Commodore shares will stabilize in the 15x-20x range, this placing a projected price on Commodore shares of $105-$140.

Purchase of Commodore International common stock is now recommended.

Analysis: First Quarter Results

The following are the results reported for Commodore's first quarter ended September 30, 1982:

	First Quarter Ended September 30th		
	1981	1982	% Change
Sales (millions)	$54.2	$103.3	+90.5%
Net Income (millions)	$ 7.3	$ 13.4	+83.6%
Earnings Per Share	$ .47	$ .87	+85.1%

In regard to the above, it should be noted that:

1) After-tax profit margins were 13.0% in fiscal 1982 versus 13.5% in the year-earlier first quarter, this related to a slightly higher corporate tax rate (20.6% vs. 19.7%) and slightly lower pre-tax profit margins (16.3% vs. 16.7%) resulting from carefully budgeted television advertising which did not occur in last year's first quarter. Considering the higher tax rate and incremental (versus the year-earlier quarter) advertising, we are impressed with the near-maintenance of after-tax profit margin levels.

2) Commodore's $55 price cut on its VIC 20 home computer to $155 (wholesale) from its original $210 price, while announced in late-August, negatively impacted full first quarter results since Commodore management, wisely, gave full price protection to all its dealers with VIC 20's in stock at the time of the price cut. We estimate that this could have cost Commodore, net, as much as $1.0-$1.5 million, or $.06-$.10 per share if only 40,000 to 50,000 VIC 20's in dealer inventories (a one month supply) were affected. In spite of this, Commodore still reported sales, net income, and earnings per share ahead of the most optimistic expectations.

3) Most important, the September 30th quarter just ended was the first first quarter in more than five years that was ahead of the fourth (June 30th) quarter in sales. Traditionally, Commodore's first quarter (which includes the summer vacation months of July and August) records lower sales than the fourth quarter. The fact that the first quarter was, for the first time, ahead of the fourth quarter ($103.3 million vs. $97.4 million) leads us to believe that the current (December 31st) quarter will be much better than most might expect, as will be discussed below.

Forecast: Second Quarter Results

We believe that Commodore's second fiscal quarter (ending December 31, 1982) results will be better than most now expect.

The following summarizes our forecast for the quarter ending December 31, 1982 compared to year-earlier results:

	Second Quarter Ending December 31st		
	1981	1982E.	% Change
Sales (millions)	$70.1	$ 145	+107%
Net Income (millions)	$ 9.3	$19.3	+107%
Earnings Per Share	$ .61	$1.25	+105%

If the above results are achieved, it would represent an acceleration in both sales and earnings growth from previously recorded levels and could, in fact, take many investors by surprise.

We have arrived at this new upwardly revised second quarter forecast based upon the following factors:

1) Last year's second quarter sales results of $70.1 million were 29.6% ahead of fiscal 1982's first quarter sales ($54.1 million). If only the same percentage relationship sustained between this year's yet-to-be reported second quarter and already reported first quarter when sales reached $103.3 million, this would put December 31, 1982 sales at $134 million. However, since the first quarter results marked the beginning of a sales and earnings acceleration on a quarter-to-quarter sequential basis, we believe sales of at least $140 million and, more likely, $145 million are achievable for the current (December 31st) quarter.

2) The current quarter includes the heavy Christmas selling season, something that undoubtedly will help sales;

3) The current quarter's sales reflect higher production levels of both the VIC 20 home computer as well as initial shipments of the Commodore 64; and

4) The current quarter's sales will also benefit from a reduced VIC 20 retail selling price of $170-$180 versus $240-$250 at retail during the first quarter.

In summary, we believe Commodore's sales and earnings will be better than most expect.

Fiscal 1983 and 1984 Outlook

While we believe the current quarter, aided by the Christmas selling season, will reflect outstanding gains for Commodore, we believe that the March (third) and June (fourth) quarters will reflect equally dramatic gains for Commodore.

Among the factors that lead us to believe Commodore will achieve outstanding gains over the next six months and through fiscal 1984 are the following:

1) In spite of the rapid build-up in Commodore's VIC 20 production from 40,000 units in August to an estimated more than 80,000 for the month of December, demand for the VIC 20 continues to outpace Commodore's production. While Commodore continues to increase VIC 20 production to what we believe could reach 100,000 units monthly within 60 days, or during February, sell-through of the VIC 20 at the retail store level has been excellent, while new customers continue to add the VIC 20 to their product line. Within the past 30 days, we have learned that J.C. Penney, the nation's third largest mass merchandiser, has placed an initial order to carry the VIC 20 for the first time during 1983, while K-Mart, the nation's second largest mass merchandiser, has decided to expand the number of stores carrying the VIC 20 from 1,100 to all 1,800 of its stores in early-1983. We expect Sears to also carry the VIC 20 for the first time in 1983.

2) The $595 Commodore 64 began shipping in August at the rate of 5,000 units monthly, a rate that rose to over 15,000 units in November, and is expected to rise to 25,000 units monthly within 30 days, or by the end of January. By comparison, the five year old Apple II is now shipping at an estimated rate of 25,000-30,000 units per month. Quite amazingly, in less than five months, sales of the Commodore 64 have near-achieved a unit sales success level equal to what it took Apple five years to accomplish!

For calendar 1983, we believe the Commodore 64 will achieve sales of 30,000-40,000 units monthly which, at $360 each, could mean an incremental $130 million to $145 million in revenues. Add-on peripheral sales of disk drives, printers and software should add an amount near equal ($125 million to $150 million) in sales to this, thus giving Commodore almost $250 million in new sales added to an existing and growing base of sales from its PET, CBM, and VIC microcomputer systems.

3) Commodore's national print and television advertising campaign is now only nine months old. The cumulative benefits from this ongoing campaign have not yet been fully realized by Commodore as demand for the VIC 20 and Commodore 64 continues to outrun supply. We expect that the second half of fiscal 1983 and all of fiscal 1984 will benefit from the cumulative impact of this advertising campaign as it enters the beginning of its second full year in April, 1983.

4) We believe that Commodore will lower the price of both the VIC 20 and Commodore 64 in 1983, something that should lead to further accelerating unit demand for both these products. (See discussion of "Price Trends" which follows on page 9.)

5) Commodore's new line of small business microcomputers will begin shipping in 60-90 days, something that should give a further boost to sales and earnings in the final quarter of fiscal 1983 and throughout fiscal 1984. Each of these new microcomputer systems has extremely attractive price-to-performance features, including Commodore's B700 microcomputer which compares very favorably to the Apple III; the selling price of the Commodore B700 is half the price of the Apple III ($1695 versus $3,495), while both microcomputers are powered by Commodore's 6500 series microprocessor, both have 128K bytes of built-in user RAM, and both microcomputers include built-in dual disk drives and monochrome display monitors.

6) If Commodore remains true to past tradition, the upcoming Consumer Electronics Show in Las Vegas, Nevada on January 6th-9th should witness several

new and exciting microcomputer systems from Commodore, these providing new foundations and impetus for growth in fiscal 1984 and 1985.

Competition

No multi-billion industry is shared by but one or two companies and the microcomputer industry is no exception.

Currently, there are over 50 companies involved in the manufacture and sale of microcomputer systems.

To date, most of the product competition has centered in the medium to high end of the industry, that is for systems priced at $1,500-$3,000 at retail, while price competition has been most intense at the low-end.

The market for all microcomputer systems--high, medium and low-priced--is immense.

IBM's well publicized entry into the microcomputer industry almost one year ago was, to many, going to spell the downfall for Apple, Tandy and Commodore. Not only were these critics proven wrong, but Apple's sales continued to grow by more than 70% over the past year, while Commodore's worldwide microcomputer sales rose almost 70%, including a gain of over 100% in the United States, of which its higher-priced small business microcomputer sales in the U.S. rose over 80%.

There has been much speculation that IBM will unveil a new lower-priced personal computer at the Consumer Electronics Show in Las Vegas, Nevada, January 6th-9th. While we believe this is possible, we don't think it probable. If IBM does bring out a new product, we believe it will be in the $800-$1,000 price range and not be a true low-priced (under $300) home computer.

Finally, one must remember that IBM's Personal Computer is the only product in the IBM line that is manufactured for it on the outside and it took the company almost a full year to bring production up to an estimated 20,000 units monthly, a far cry from the 80,000+ units now being produced monthly by Commodore.

There will undoubtedly be other entries in each sector of the microcomputer market. As far as we are concerned, however,

the worst as far as competition goes is behind as the start-up, manufacturing and marketing costs of initial entry into this industry is now prohibitively high and microcomputer system's selling prices so low that entry for all but the most sophisticated is now extremely difficult.

Price Trends

Just as 1982 witnessed lower prices for most major microcomputer systems, so, too, do we believe prices will come down in 1983.

We believe the price of both the VIC 20 and Commodore 64 will be reduced by Commodore as a way of Commodore management's passing along high level production efficiency savings to consumers and, simultaneously, further broadening market demand much as they did with their price cut in August.

As Commodore has increased production of the VIC 20 from less than 20,000 units monthly nine months ago to over (an estimated) 80,000 monthly at present, and as the ramp-up in Commodore 64 production grows from less than 5,000 units five months ago to (an estimated rate of) 25,000 monthly at present, we believe manufacturing costs have dropped dramatically.

Commodore management has expressly stated that it does not wish to take short-term windfall profits and create a pricing umbrella under which other manufacturers might take a lower pricing initiative. Since both the VIC 20 and Commodore 64 are two of the highest gross profit margin microcomputer systems for Commodore, we envision further price reductions by Commodore for both these products in 1983.

We would not be surprised to see the VIC 20 being sold (at retail) for $140-$150 in 1983 (compared to $170-$180 at present, and the Commodore 64 selling (at retail) at under $400 compared to $595 at present. (Note: For those not familiar with these two microcomputers, they are both built in identical housings, with identical keyboards, user ports, and so forth, all of which has helped Commodore significantly lower manufacturing costs on both microcomputers).

Lower prices will, in our opinion, lead to dramatically increased demand for both microcomputer systems, just as occurred in August when VIC 20 prices were reduced.

Market Potential: 1983, 1984 and 1985

For calendar 1982, we estimate that two million home computers were sold, broken down as follows:

	Estimated Units Sold	% of Market
Commodore VIC 20	700,000	35%
Texas Instruments 99/4A	500,000	25%
Atari 400	300,000	15%
Atari 800	200,000	10%
Timex-Sinclair	300,000	15%
	2,000,000	100%

Most of these microcomputers, perhaps as many as 75%, were sold in the second half of 1982, this putting annual sales at a rate well in excess of 3 million units.

With projected lower selling price points in 1983, the availability of more and better software, and a better general economic environment, sales of 4-5 million home computers in 1983 appears a near certainty.

Looking ahead to 1984, we believe sales of 8-10 million units or more appears quite realistic and attainable.

As a point of reference and perspective to these forecasts, one must remember that initially, at least in 1982 and 1983, home computer sales will for the most part be to people who never purchased a pure home video game machine and want more functionality in a microcomputer than a pure game machine could provide.

The sales forecast of 8-10 million units in 1984 will be to two types of people: the first are those who want a functional home computer that new types of applications software will provide by 1984, while the second group will purchase a home computer as a replacement market for the more than 25 million pure video game only machines that will have been sold by year-end 1983 (on a cumulative basis).

The replacement market element is quite important as one must remember that if 8 million home computers are sold in 1984, this will merely equal the number of pure video game only machines that were sold in 1982, or two years earlier.

By 1985, many initial buyers of very low-priced home computers will be upgrading their initial purchases by purchasing a higher level microcomputer such as the Commodore 64. If millions of consumers have two television sets, two cars, and two homes, why shouldn't they have two microcomputers by 1985-1986?

Equally important when looking at the entire microcomputer market sales potential over the 1983 to 1985 time period, one must realize the fact that sales of microcomputer peripheral devices such as disk drives, printers, and software can easily add 3-4 times the total sales to manufacturer's revenues when related to the initial sales of the base microcomputer by itself. This effect will be cumulative, i.e., a company like Commodore will benefit in 1983 not only from the sale of individual computers, but equally well when the purchaser of a single computer in 1982 decides to buy disk drive or printer in 1983, while 1984 and 1985 will benefit in a similar cumulative manner.

Conclusion

For fiscal 1983, ending June 30th, or six months from now, we estimate Commodore International will earn $4.60 per share, with a further gain to $7.20 per share estimated for fiscal 1984.

The following summarizes Commodore's sales, net income and earnings per share record over the past five years with estimates for fiscal 1983 and 1984 included:

	1977	1978	1979	1980	1981	1982	1983E	1984E
Sales ($ millions)	46.2	50.2	71.1	125.6	186.5	304.5	550	850
Net Income ($ millions)	1.5	3.4	6.0	14.5	24.9	40.6	70.8	111
Earnings Per Share ($)	.10	.24	.41	1.04	1.61	2.64	4.60	7.20

With less than six months until the end of fiscal 1983, it should be but 2-3 months before investors focus full attention on fiscal 1984's estimated per share net of $7.20.

In each year for the past six, Commodore shares have risen in price to a minimum price-to-earnings multiple level of 15x and,

in many instances, risen to over 25x. Currently selling at just 9.4x estimated fiscal 1984 earnings per share of $7.20, a similar multiple revaluation relative to year's past would place Commodore shares at a level of $105-$175, or 50% to 150% above their most recent price. Purchase is now recommended.

Ronald B. Koenig
Managing Director

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